ECONOMIC VIEWPOINT

Ontario Budget 2025 Preview

From Promises to Reality: Exploring Ontario's Options for a Tariff-Proof Budget

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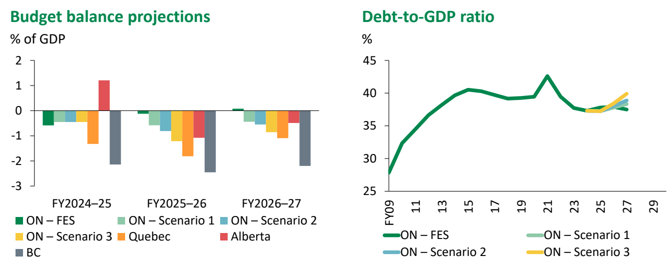
Highlights

- Ontario will be tabling a post-election budget amid mounting economic headwinds from US tariffs. Despite high uncertainty, several key themes are expected in the budget: revenue is likely to take a hit, while spending should rise as the government deploys resources to support crucial sectors vulnerable to the impact of US tariffs and Canada's countermeasures. This report assesses the possible fiscal path through three potential scenarios.
- A better handoff from FY2024–25 (FY2025) is highly likely, well positioning the province to weather the storm and ensuring it has the fiscal capacity to respond to tariff impacts.
- Our estimates indicate that the tariff-led slowdown could result in significant revenue downside ranging from -$1B to -$4.5B in FY2026.
- The government's tariff-focused campaign platform promised up to $8B in support measures alongside other priorities such as education and training, affordability, healthcare and public safety. Altogether, these initiatives total approximately $15B that could be incorporated into operational spending.
- Using three possible scenarios, we expect Ontario's fiscal position to deteriorate due to its high exposure to US tariffs. The deficit could widen to between 0.6% and 1.2% of nominal GDP in FY2026—still well below levels seen during recent recessions—before narrowing to 0.4% to 0.9% in FY2027 (graph 1).
- In all likelihood, Ontario should maintain its fiscal advantage over some of its peers, likely outperforming Quebec, British Columbia and possibly even Alberta in FY2026 and FY2027 under the two more probable scenarios.

Graph 1
Fiscal Deterioration Is Expected, Yet Ontario Maintains the Edge

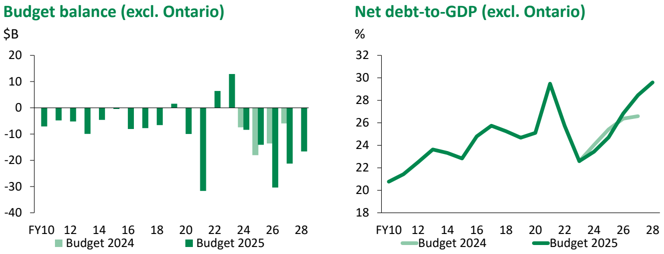


Scenario 1: Mild recession, partial platform implementation. Scenario 2: Mild recession, full platform implementation. Scenario 3: Severe recession, full platform implementation. Could be considered as a worst-case scenario.
Provincial Budget Documents and Desjardins Economic Studies

Uncertainty has dominated the 2025 provincial budget season. Amid highly unpredictable trade policies south of the border, all provinces face significant downside risks to revenue while grappling with spending pressures due to continued cost overruns in delivering key services. Meanwhile, it is crucial to retain the capacity to address potentially damaging outcomes from trade uncertainty and support affected businesses and individuals while mitigating the economic fallout from tariffs. With its critical manufacturing sector, Ontario is particularly vulnerable to lower US demand and could experience these headwinds more acutely than many of its peers.

Without fully accounting for the impact of tariffs, provinces that have released their budgets so far have all reported deteriorating bottom lines driven by spending increases that far exceed limited revenue gains. Spending is set to continue growing on a per capita basis this fiscal year. Collectively, these provinces forecast widening deficits to levels reminiscent of the pandemic, with large shortfalls persisting and pushing their aggregate net debt-to-GDP ratios back to pandemic peaks after three years (graph 2).

Graph 2
2025 Budgets Reveal Broad-Based Fiscal Deterioration



Provincial Budget Documents and Desjardins Economic Studies

Ontario is relatively well positioned to face these challenges. In this note, we explore possible scenarios for Ontario's fiscal outlook leading up to the province's 2025 budget. Based on current information, we find that Ontario will likely experience similar bottom-line deterioration as other provinces. However, it is expected to fare better than some of its peers, particularly Quebec and British Columbia.

Prudent Planning Pays Off

Ontario used very conservative assumptions in its last fiscal plan. In its Fall Economic Statement (FES), the forecast was based on a real growth assumption of 0.9% for 2024, significantly lower than our current estimate of 1.5% growth for 2024. This aligns with the faster growth scenario outlined in the province's latest plan, which could see the FY2024–25 (FY2025) deficit shrink by $2.4B. That more than offsets the negative impact of revenue loss associated with the reversal of capital gains inclusion rate changes, with a fiscal impact totaling $3.3B over FY2025 to FY2027.

A stronger handoff positions the province well heading into the downturn. In its FES, the province anticipated an almost balanced budget in FY2026 and a comfortable return to surplus in the following fiscal year. However, as observed in other provinces, spending pressures could derail the tight consolidation path laid out by the province. Ontario currently has the lowest program spending per capita and has seen the least spending increase relative to pre-pandemic levels. The current plan penciled in minimal growth of 0.6% in program spending from FY2025 to FY2026. That said, $3B of FY2025 spending was allocated to a one-time taxpayer rebate, and excluding that, program spending growth would be 2.0%—a more realistic pace yet still well below the combined rate of population growth and inflation.

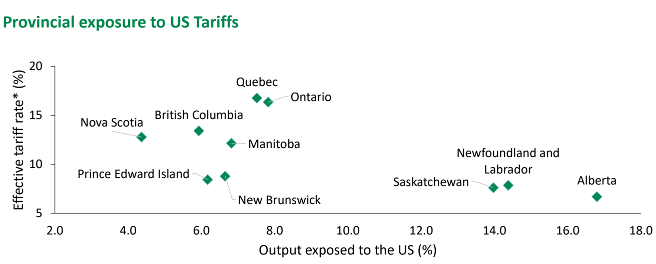
The province also has substantial prudence built in to offset potential downsides. In its FES, the government maintained a healthy balance of $1.7B for FY2025 in its contingency fund. The plan also included a $1B reserve for FY2025, and with growth likely exceeding previous projections, this sets the stage for potential outperformance.

Revenue Takes a Hit as the Economic Outlook Darkens

The economic outlook for Ontario has significantly darkened for this year and next. In its FES, the province assumed real growth of 1.7% in 2025 and 2.3% in 2026, which seemed prudent at the time. However, the trade dispute initiated by the new US administration is expected to be a substantial drag on the Canadian economy.

Although the announcement on "Liberation Day" confirmed the exemption of CUSMA-compliant goods for now, reducing the effective tariff rate of all exports to the US to around 16% for Ontario, the impact remains material (graph 3). As more producers align with CUSMA regulations, these rates could significantly decrease. However, the persistent uncertainty, particularly regarding the future of the province's auto industry, indicates considerable downside risks to the economic outlook.

Graph 3
Ontario Remains Among the Hardest Hit Post "Liberation Day"



* Based on 2024 customs data regarding Canada-United States-Mexico Agreement (CUSMA) compliance.
Statistics Canada and Desjardins Economic Studies

Our estimates indicate that the tariff-led slowdown will result in considerable revenue downside. Assuming the tariffs remain in place throughout the year and are gradually lifted entering 2026, we forecast Ontario's economy will dip into a mild recession this year, with three quarters of negative growth and annual average real growth slowing to 0.7% in 2025. The unemployment rate could peak at close to 9% later this year.

A more severe recession is also possible. In the slower growth scenario provided in the province's Fall Economic Statement, real growth is projected to contract at roughly twice the rate we anticipate in our forecast, leading to minimal growth of 0.3% this year compared to last. Overall, between our mild recession scenario and the government's recession scenario, revenue loss could range from $1B to $4.5B in FY2026 relative to the current forecast. In contrast, Quebec—the province most affected by US tariffs—estimated a fiscal impact of between $0.9B and $2.1B under two tariff scenarios in its 2025 budget released on March 25.

Spending Will Rise as the Government Delivers on a Tariff-Focused Campaign Platform

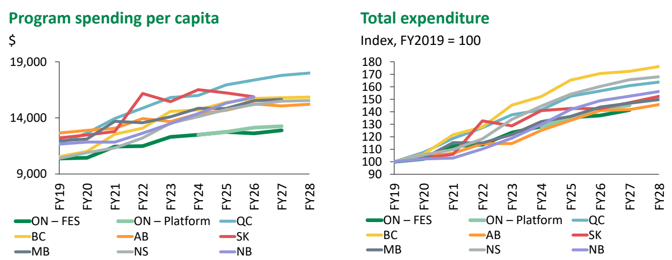
The Progressive Conservative Party of Ontario won the February election with a platform heavily focused on addressing trade tensions. Their campaign promises included over $40B in new investments, loans and financial supports aimed at protecting workers, unions, businesses, municipalities and communities from the impacts of US tariffs. We estimate that around $15B will be added to operational spending, with approximately half ($8.2B) dedicated to tariff relief measures.

The proposed tariff-related support measures appear targeted and temporary. The government recently announced a 6-month deferral of selected corporate taxes, providing $9B in temporary cash flow, with minimal impact on this year's fiscal position, as all owed taxes are due by October 1, 2025. Additionally, a $2B rebate through the Workplace Safety and Insurance Board (WSIB) has been announced to support businesses and help keep workers on the job. Other potential budget measures proposed in the campaign platform include $5B for the Protect Ontario Account, up to $3B in payroll and premium relief, $40M for municipalities affected by tariffs and $120M to increase wholesale alcohol discounts for bars and restaurants.

Beyond tariff support, the platform addresses a wide range of priorities, with significant new spending proposed in education and training, affordability, healthcare and public safety. Major promises include $1B more for skilled trades training, $705M to expand STEM and skilled trades training capacity at post-secondary institutions, $743M to address immediate healthcare staffing needs and permanent gas tax cuts with a fiscal impact of around $1B annually.

These campaign promises will add to the province's spending profile, with the bulk of it concentrated in FY2026 as tariff support. Even if the entire platform was implemented, Ontario still would have the lowest program spending per capita and among the lowest expenditure growth compared to pre-pandemic levels (graph 4).

Graph 4
Ontario's Spending Is Set to Rise Yet Remains Low



Provincial Budget Documents and Desjardins Economic Studies

Tariffs Will Likely Hit Ontario's Finances Hard but Are Unlikely to Erode the Province's Advantage

Tying all the pieces together, we explore three potential scenarios for Ontario's public finances, accounting for the recession induced by tariffs on Canadian exports to the US.

Scenario 1: We assume a mild recession with three quarters of negative growth and annual average real GDP growth slowing to 0.7% in 2025 and 0.8% in 2026 as in our latest forecast. We also assume that only half of the $8B tariff relief package will be incorporated into operational spending and that other policy priorities outlined in the platform will be implemented.

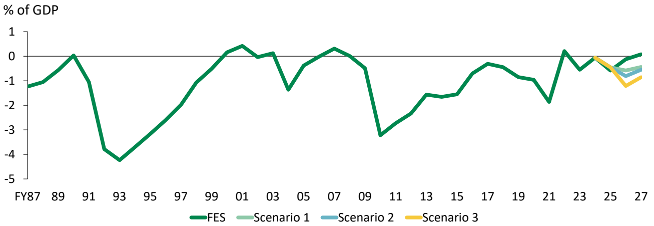
Scenario 2: This scenario maintains the mild recession forecast but incorporates the complete implementation of the party's platform, adding approximately $15B to the operational budget over two years.

Scenario 3: This scenario assumes a more severe recession, as projected in the slower growth scenario provided in the FES. Real GDP growth is expected to contract at roughly twice the rate anticipated in our forecast for the last three quarters of the year, leading to minimal growth of just 0.3% for the year. This scenario predicts a revenue loss of $4.5B in FY2026, with full implementation of the party's platform.

Scenarios 1 and 2 represent likely outcomes based on current information, while scenario 3 could be considered a worst-case scenario. The first two scenarios see the deficit widen to 0.6% to 0.8% of output in FY2026 before narrowing to 0.4% to 0.6% of output in FY2027. Ontario is expected to outperform Quebec, BC and even Alberta, which has maintained a notable fiscal advantage over most provinces for the past four years. In the worst-case scenario (scenario 3), Ontario's deficit could widen to 1.2% of GDP in FY2026 before narrowing to 0.9% in FY2027. Despite being slightly worse off than Alberta, Ontario would still fare better than Quebec and BC. In any scenario, Ontario's projected larger deficits are much narrower than the historical periods of financial stress the province has experienced (graph 5 on page 4).

Graph 5
Ontario's Deficits Aren't as Big as They Once Were

Ontario budget balance projections



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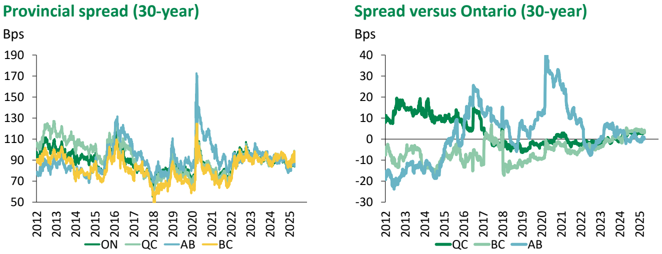
Borrowing and Debt Management

If tariffs remain in place and continue to dampen growth, Ontario's deficit could be \$5B–\$13B higher than previously planned. This situation necessitates government support as promised in the campaign platform. Consequently, FY2026 borrowing is expected to significantly exceed the \$35B planned last fall, with \$28B designated for refinancing maturing debt.

Updates to the infrastructure spending plans are expected to be noteworthy. The government remains committed to major highway and transit projects to alleviate gridlock while continuing to build new healthcare facilities. As observed in other provincial budgets, Ontario is likely to increase capital spending in these areas this year and next to counter anticipated softness in private sector investment. New infrastructure projects will further contribute to capital spending and financing needs.

Ontario's updated fiscal plan will be crucial in setting the benchmark for other provinces' bond spreads. Since December, provincial spreads have widened, particularly on the long end, yet they remain in line with last year's levels and are still narrow compared to historical periods of fiscal stress (graph 6).

Graph 6
Spreads Have Widened but Remain Below Historical Levels



Bloomberg and Desjardins Economic Studies

While spreads have generally moved in tandem, this year has seen spreads for other provinces, notably Quebec and BC, widen relative to Ontario. We expect Ontario to maintain its advantage over these provinces. However, this gap could narrow if Ontario's fiscal position deteriorates more than anticipated.

Appendix: How Other Provinces Planned for Tariff Impacts

Heightened uncertainty has made it challenging for provinces to plan for the future, especially as tariff headlines emerge concurrently with budget releases. Given the significant potential impact of these tariffs, we have summarized the tariff-related risks accounted for in the budgets (table 1).

Table 1
How to Tackle Tariffs? The Provinces Have Different Answers

	NS	NB	QC*	MB	SK	AB	BC
Budget balance reported (FY2026) (\$M)	-898	-599	-11,430	-794	12	-5,211	-10,912
% of GDP	*-1.4*	*-1.2*	*-1.8*	*-0.8*	*0.0*	*-1.1*	*-2.1*
Real GDP (%)	2.0	1.1	1.1	1.7	1.8	1.7	1.8
– Desjardins**	1.3	1.1	0.9	0.8	1.4	1.8	1.5
Contingency (\$M)	200	50	2,000	200	0	4,000	4,000
Tariff spending – Baseline	0	162	803	0	0	0	0
Expected tariff impact (\$M)	Not provided	Included	-1,200***	-1,100	-1,400	Included	-3,400
Revenue			-1,200	-600	-1,400		-3,400
Spending			0	500	0		0

* Before deposits into the Generations Fund. ** Assumes a 25% tariff on Canadian exports and a 10% tariff on energy products.
*** In addition to the tariff impact already accounted for in the baseline.
Provincial Budget Documents and Desjardins Economic Studies

In terms of fiscal outlook, Alberta, Quebec, Nova Scotia and New Brunswick have incorporated different degrees of weaker growth to reflect the impact of tariffs. On the spending side, Alberta and BC have each included a sizable contingency of \$4B to cover unforeseen expenses. However, BC has not factored tariff impacts into its growth assumptions, leaving more downside risk that may not be covered by this buffer. Some other provinces have also set aside contingencies, such as Manitoba (\$200M), Nova Scotia (\$200M) and New Brunswick (\$50M). Some pre-emptive relief measures have been announced, though nothing major so far. For instance, Quebec has allocated \$803M this fiscal year to stimulate wealth creation, support investment and assist businesses affected by tariffs.

What's not included in the fiscal outlook appears more significant. BC estimates that downside risks from tariffs could result in additional annual shortfalls ranging from \$1.7B to \$3.4B. Quebec expects an additional \$1.2B deficit in FY2026 in a full-blown trade war scenario. Saskatchewan and Manitoba project deterioration of \$1.4B and \$1.1B, respectively, in alternative scenarios. These potential shortfalls tally up to over \$7B.